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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
OCTOBER 22, 2004 ISSUE

¶1. Summary. Each week, AMEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:
- Third Quarter FDI Improves but Still Low;
- November GDP Revisions May Boost Growth;
- Fitch Upgrades Ratings to Stable;
- Moody's Ratings Agency Considers South African Upgrade;
- Improvement but Poverty Still High;
- Study Reveals Negative Employment Trends;
- Leading Economic Indicator Rises;
- South Africa's Poor Are Saving; and
- Economy Should Attract Increased Investment. End Summary.

THIRD QUARTER FDI IMPROVES BUT STILL LOW

¶2. BusinessMap Foundation said third quarter foreign direct investment (FDI) into South Africa at R27.8 billion ($4.3 billion using 6.5 rands per dollar) improved over second quarter's disinvestment primarily due to Barclays' announced plans to obtain a majority share in ABSA bank. The rise in the third quarter followed a R10.6 billion disinvestment in the second quarter because of Thintana consortium's announced plans to sell its R 6.1 billion share in Telkom. Subtracting the R1.8 billion of disinvestment that occurred (primarily in the consumer goods sector), net FDI during the third quarter was R26.1 billion. In 2003, Africa attracted 2.7 percent and South Africa accounted for 1 percent of total FDI in the world. Quarterly FDI into South Africa is small, volatile, and impacted by a few large transactions that can affect quarterly and yearly averages. Source: Business Day, October 21; BusinessMap FDI Third Quarter, October 20.

¶3. Comment. BusinessMap Foundation collects foreign direct investment data by using press accounts to count both FDI intentions as well as actual investments. It uses the same FDI definitions as the South African Reserve Bank (SARB) by including only long-term investment, and cases with more than 10 percent ownership as well as reinvestment activity; however, it includes intentions to invest when they are announced as well as actual investment. Therefore, this method captures the investment mood, but does not measure actual inflows. The timing of recording streams of investment leads to the primary difference in investment numbers between BusinessMap and SARB. In addition, BusinessMap's database also allows aggregation by industry, unlike the SARB data. End comment.

NOVEMBER GDP REVISIONS MAY BOOST GROWTH

¶4. On November 30, Statistics SA (Stats SA) will revise gross domestic product (GDP) figures upwards, after new data suggested higher levels of economic activity than previously stated. GDP figures from 1998 to 2004 will be revised. GDP grew 1.9 percent in 2003, but has since accelerated gradually following a recovery in the manufacturing sector. The latest figures show that GDP increased at an annualized rate of 3.9 percent in the second quarter, the fastest growth experienced since 2002. Updated every five years, the base or reference year for the GDP figures will be changed from 1995 to 2000. The GDP figures will also be benchmarked, an annual process that combines high-frequency data with less frequent, but more accurate, data. After making improvements to some of its surveys, Stats SA found that it had underestimated the size of the manufacturing sector by 17 percent, while retail sales had been underestimated by 20 percent before the revisions were made. It is unlikely that the underestimation of total GDP will be of the same magnitude, because not all industries had increased economic activity. Source: Business Day, October 21.

FITCH UPGRADES RATINGS TO STABLE

¶5. Fitch Ratings revised its outlook on South Africa's sovereign ratings to stable from positive with the ratings for its long-term foreign and local currency unchanged from its March 2004 rating of BBB and A- respectively. Fitch cited improvements in external liquidity, reduced external debt, and improved prospects for sustaining growth above 3 percent over the medium-term as primary reasons for the sovereign ratings upgrade. South Africa's gross international reserves, currently $12.5 billion, increased by $4 billion since February 2004. Net external debt (debt owed to foreigners less the foreign assets of the banking system) is projected to fall to 5 percent of GDP in 2004, compared to 17 percent in 2002. Fitch's announcement of the upgrade comes several days after Moody's announcement of putting South Africa on review for a possible upgrade. Source: I-Net Bridge, October 21; Business Day, October 22.

MOODY RATINGS AGENCY CONSIDERS UPGRADE
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¶6. International credit ratings agency Moody's placed South Africa's current Baa2 sovereign rating on review for a possible upgrade, committing the agency to a decision within three months. A further incremental upgrade by Moody's would place South Africa in the 'upper' investment grade category of Baa1, two levels above investment grade. Other international ratings agencies, such as Standard & Poor's and Fitch currently rank South Africa at one level above investment grade: however, Moody's has traditionally been the first to upgrade. Upgrading South Africa's credit rating will put the country in a better position to attract significant capital inflows, while reducing the cost of borrowing in the offshore markets. Countries such as China, Malaysia and Thailand have Baa1 rankings; with higher economic growth rates, they have attracted more foreign direct investment (FDI). Moody's imminent upgrade of South Africa's rating is another endorsement of the country's minimal reliance on foreign debt, improved external liquidity position and its macroeconomic policies. Moody's cited South Africa's weak economic growth relative to other emerging market countries and low levels of foreign reserves as constraints to its rating. Moody's did note the strong economic performance this year, particularly a strong upturn in investment spending and robust demand, and South Africa's improved international liquidity position. Source: Business Report, October 17.

IMPROVEMENT BUT POVERTY STILL HIGH

¶7. Research Survey's 2004 poverty index ranking improved to 39, up from 43 last year. The poverty index ranks poverty levels on a scale of 100 with 100 representing extreme poverty and 0 representing complete affluence. Details of the survey, conducted among a sample of 3,504 citizens, concentrated on a special poverty index based on the provision of basic services, access to telecommunications and transport, and adequacy of nutrition. Three groups fared the worst in the rankings, including: (1) those living in rural farm workers' quarters at 70; (2) those living in urban squatter shacks at 63; and (3) those living in rural villages at 60. The quality of life improved once people had formal dwellings. People in formal houses in the former townships scored 30. The survey highlighted the inequalities which exist between the various population groups, with blacks living in townships and informal settlements scoring an overall average of 47 (improving from 51 last year), while those living in mostly white suburbs scored a high ranking of eight. By province, the poorest were the Eastern Cape at 50 (improving from 53), Limpopo at 48 (improving from 50) and Mpumalanga at 47 (improving from 56). The wealthiest live in the Western Cape and Gauteng, scoring 22 and 27 respectively. One in five adult South Africans said they could not afford to eat the correct foods. This figure rose to one in four people for the over 50 population, and one in three for those at the bottom end of the income ladder and the unemployed. Source: SAPA, October 18.

STUDY REVEALS NEGATIVE EMPLOYMENT TRENDS

¶8. The Development Policy Research unit of University of Cape Town's School of Economics released an employment study commissioned by the President's Office. Its findings described employment trends between 1994 and ¶2002. The South African economy created 1.6 million jobs, however, the labor force increased by 5 million. For every 100 South Africans seeking employment, only 32 found work of some kind. In addition, unemployment among university graduates has, proportionally, increased more than in any other education sector -- with African

graduates hit the worst. The study cited possible reasons for high unemployment among African university graduates including the perceived quality of the tertiary institution that students attended, the public sector restructuring with public sector being a major source of black African employment, and training in fields with less employment potential. Source: Cape Argus, October 15.

LEADING ECONOMIC INDICATOR RISES

¶9. South Africa's August 2004 leading economic indicator, compiled by the South African Reserve Bank (SARB), increased 10.7 percent (y/y) compared to July's 11 percent increase. Contributing positively to growth were average manufacturing hours worked, job advertisements, manufacturing orders, building plans approved, business confidence, the interest rate spread between the money market and capital market instruments, equity prices, and real M1 money supply. Negative factors were the inventory/sales ratio, commodity prices, and the leading indicator of major developed countries. The SARB in March 2004 revised its leading and coincident business cycle indicators, the second revision since it first published business cycle indicators in 1983. The leading indicator has been pared down to 13 components from 21, while the coincident indicator has been cut to 5 from 7. The new indicators are also less volatile than the old indicators, while the lead time for the leading indicators has been extended to 15 months from the previous 11.5 months. Source: I-Net Bridge, October 18

SOUTH AFRICA'S POOR ARE SAVING

¶10. Research by FinMark Trust, presented to the annual South African Savings Institute's symposium, highlights how low income households save. The informal savings industry is fairly well developed already, with burial societies (where monthly payments are made to cover funeral costs) and stokvels (where members deposit monthly and withdraw annually) often the most popular forms of community-based savings schemes. 5.6 million people in the lowest income categories try to save regularly and many poor people demonstrate a propensity to save. However, most South Africans would prefer a bank account to informal savings schemes, with confidence in bank accounts fairly high, even among the poor. Bank accounts are the most popular form and the preferred method of actual savings with 10.3 million out of 13.2 million savers in South Africa holding bank accounts. This finding holds with people in the lowest income brackets as well. The informal and formal parts of the financial services industry are interlinked. FinMark Trust says about 75 percent of stokvels have group bank accounts. It also appears that, as incomes improve, savers do not abandon informal methods of savings, such as burial societies and stokvels. Ross Esson, a Cape Town postgraduate student, presented research at the conference showing that burial societies were the most popular forms of savings among people in Cape Town's largest townships, Khayelitsha and Mitchell's Plain, particularly among those who earned relatively high wages. Bank savings as a proportion of total savings increased as incomes grew, but stokvel savings remained relatively stable across all income categories surveyed. Females, although 41 percent more likely than men to save, would tend to save less than males, mainly because their income levels were lower. Source: Business Day, October 19.

¶11. Comment. Historically, the major South African banks have ignored servicing the low-income population. South African banks earn more from bank charges than from returns of investment capital. Servicing the 'unbanked' population and increasing the savings rate are current government objectives. Approximately 30 percent of South Africans (over 13 million) are without a bank account. Next week, the government will announce a low-cost banking initiative that should improve access to banking in all geographic areas. The new national bank account, or 'Mzansi' account, will be launched on October 25th by the big four South African banks as well as Postbank, the South African Post Office's savings institution. The Black Economic Empowerment (BEE) financial sector charter drove this banking initiative. In addition, the National Treasury has recently introduced a retail bond in order to encourage a savings culture among the population. End comment.

ECONOMY SHOULD ATTRACT INCREASED INVESTMENT

¶12. Increased local and foreign direct investment will lead to improved growth as the benefits of inflation-targeting begin to impact South Africa's economy, according to Martin Jankelowitz, head of market and economic research at Investment Solutions. A virtuous circle will impact the economy as rand strength, leading

to lower inflation, facilitated by declining nominal interest rates, will provide strong returns on local assets and expanding business opportunities. Spending by consumers, the primary beneficiaries of the low inflation, low interest-rate environment, has increased by over 4 percent during the last three quarters. Private fixed investment increased by 5.4 percent, supporting the view that the benefits of inflation targeting are starting to be felt. The South African Investec PMI, essentially a manufacturing activity index, indicates that manufacturing is expanding at its fastest pace in almost two years, with all the underlying sub-indices strong, notably business activity and new sales orders. Significantly, the Employment Index has remained above 50 (indicating expansion) for six consecutive months. With business confidence indicators at a record high, expectations remain optimistic. Source: I-Net Bridge, October 20.